INDEX

	PAGE
Jurisdiction	1
Statement	2
Authorization by Solicitor General	4

IN THE

Supreme Court of the United States

OCTOBER TERM 1947

No. 572

PRUDENCE REALIZATION CORPORATION,
Petitioner,

v.

GEORGE E. EDDY, ET AL.

MEMORANDUM OF THE RESPONDENT, RECONSTRUCTION FINANCE CORPORATION, IN SUPPORT OF PETITION FOR CERTIORARI

Jurisdiction

The decree of the Circuit Court of Appeals was entered on December 8, 1947 (R. 623). Petitions for rehearing filed in that Court by the petitioner and by Reconstruction Finance Corporation were denied on January 5, 1948 (R. 650). The petition for certiorari was filed on February 4, 1948. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U. S. C., Sec. 347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U. S. C., Sec. 47(c).

Statement

This memorandum is submitted by the respondent, Reconstruction Finance Corporation (hereinafter called RFC), in support of the petition for certiorari in this case.

The respondent RFC is an intervenor in this bankruptcy proceeding. Its interest in the present litigation is two-fold:[1]

The RFC has a participation, as a creditor, of approximately 16% in the assets of the petitioner. Among these assets, which petitioner is liquidating for the benefit of the creditors of The Prudence Company, Inc., are subordinated bonds of the Debtor in the unpaid original principal amount of $1,910,300. These bonds have been rendered substantially worthless by the decision below that the unsubordinated or publicly held bonds of each Series are not income bonds as to their lien against the collateral of that Series, but are also entitled to interest at the rate originally borne by the bonds before reorganization, even though such interest was unearned by the collateral.

In addition, RFC's wholly-owned subsidiaries (acquired through foreclosure of collateral in connection with its loan to The Prudence Company, Inc.) and other corporations in which it has financial interests are the beneficial owners of unsubordinated or publicly held bonds having $203,856 of unpaid principal (originally in the principal amount of $568,700), including bonds in various Series in which the collateral is insufficient to pay the full principal. The plan of reorganization gave to such bonds the

[1] As part security for a defaulted loan of $20,000,000 to The Prudence Company, Inc., RFC also held as pledgee all the Debtor's stock. Under the Plan, RFC had the right to purchase a subordinate class of stock in the reorganized company (R. 251, 157). Through its wholly-owned subsidiaries and other corporations in which it has financial interests, RFC also presently has an interest in 11,391-8/10 shares out of a total of 113,000 of the stock of the Prudence Bonds Corporation.

right to share in surplus collateral of other Series (R. 155). The benefit of this provision, however, has been destroyed by the decision below that the publicly held bonds are entitled to interest at the rate originally borne by them, since the allowance of the claim for such interest is sufficient to prevent the existence of surplus collateral in any Series.

It is important to note that the opinion of the Court of Appeals failed to mention this latter dispute among the unsubordinated or publicly held bonds of the several Series, and the fact that its decision will give approximately $775,000 in additional interest payments over and and above the interest earned on the collateral to publicly held bonds of some Series to the exclusion of payments on account of principal to a greater number of publicly held bonds of other Series (Petition, p. 25). Instead the Court erroneously treated the case as a contest wholly between subordinated and unsubordinated or publicly held bonds in each Series (R. 615).

The existence of approximately 3½% of subordinated bonds [2] was thus sufficient to frustrate the reciprocal rights of the publicly held bonds to share in surplus collateral. These rights were part of a plan which was designed to conserve and recoup the principal of the bonds, even at the expense of interest, and which was initiated when the ultimate value of the collateral was unascertainable.

Indeed, the pattern of the reorganization was fixed before the subsidiary issue of subordination was determined. The Plan provided for income bonds, and reserved the question of whether petitioner's bonds should be subordinated to the publicly held bonds. When this disputed issue was compromised no change was made in the Plan. The guarantor's bonds merely took their subordinated place in the general reorganization scheme.

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[2] The Debtor had outstanding approximately $56,000,000 of bonds (R. 109), of which $1,910,300 were subordinated bonds (Petition, p. 25).

The respondent, RFC, believes that the decision of the Court of Appeals in this case was based upon erroneous concepts of law, and that the petition for certiorari raises substantial questions of bankruptcy law which should be reviewed here. Accordingly, for the reasons set forth in the petition for certiorari, the respondent, RFC, urges that the petition be granted.

Respectfully submitted.

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Reconstruction Finance Corporation

The filing of this memorandum is authorized.

February 26, 1948.

PHILIP B. PERLMAN, Solicitor General